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No. 95-965

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In The
Supreme Court of the United States

October Term, 1995

KEVIN M. O'GILVIE and STEPHANIE L. O'GILVIE, minors,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

*On Petition for a Writ of Certiorari to the United States
Court of Appeals for the Tenth Circuit*

REPLY BRIEF FOR PETITIONER

ROBERT M. HUGHES

Counsel of Record

JACK D. FLESHER

GREGORY L. FRANKEN

DAVID B. SUTTON

BEVER, DYE, MUSTARD & BELIN, L.C.

Attorneys for Petitioners

106 West Douglas, Suite 700

Wichita, Kansas 67202

(316) 263-8294

10 pp

TABLE OF CONTENTS

	<i>Page</i>
Further Reasons for Granting the Writ	1
I. Punitive Damages Received in a Personal Injury Lawsuit Are Excluded From Income.	1
II. Statute of Limitations Under 26 U.S.C. § 6532(b)	5
Conclusion	7

TABLE OF CITATIONS

Cases Cited:

<i>Commissioner v. Schleier</i> , 115 S. Ct. 2159 (1995)	1, 2, 3, 5
<i>Hawkins v. United States</i> , 30 F.3d 1077 (9th Cir. 1994), <i>cert. denied</i> , 115 S. Ct. 2576 (1995)	4
<i>Horton v. Commissioner</i> , 33 F.3d 625 (6th Cir. 1994) ..	1, 2, 4
<i>Paulson v. United States</i> , 78 F.2d 97 (10th Cir. 1935) ..	5
<i>Reese v. United States</i> , 24 F.3d 228 (Fed. Cir. 1994) ...	3
<i>United States v. Bruce</i> , 642 F. Supp. 120 (S.D. Tex. 1986)	6
<i>United States v. Burke</i> , 112 S. Ct. 1867 (1992)	2, 3, 5

Contents

	<i>Page</i>
<i>United States v. Woodmansee</i> , 388 F. Supp. 36 (N.D. Cal. 1975), <i>rev'd on other grounds</i> , 578 F.2d 1302 (9th Cir. 1978)	6
<i>United States v. Wurts</i> , 58 S. Ct. 637 (1938)	6, 7
 Statutes Cited:	
26 U.S.C. § 104(a)(2)	1, 2, 3, 4, 5
26 U.S.C. § 6532(b)	5
31 U.S.C. § 3328(a)(1)	6
31 U.S.C. § 3329	6
31 U.S.C. § 3330	6

FURTHER REASONS FOR GRANTING THE WRIT

I.

PUNITIVE DAMAGES RECEIVED IN A PERSONAL INJURY LAWSUIT ARE EXCLUDED FROM INCOME

The issue presented is whether punitive damages awarded to an injured party in a products liability action for wrongful death are excludable from gross income under 26 U.S.C. § 104(a)(2).¹ Section 104(a)(2) provides an exclusion from gross income for "any damages received . . . on account of personal injuries or sickness." The application of 26 U.S.C. § 104(a)(2) to the compensatory portion of the recovery in the instant case has never been an issue. Thus, in effect, respondent admits the application of 26 U.S.C. § 104(a)(2) to a portion of petitioners' recovery. The only issue is whether 26 U.S.C. § 104(a)(2) applies to the punitive damages award recovered by petitioners.

Our petition for a writ of certiorari (Pet. 9-10) established the conflict which exists between various circuit courts of appeal on the one hand and the Sixth Circuit Court of Appeals on the other. The respondent's brief in opposition (Resp. Br. 4) cites with approval a portion of the Tenth Circuit Court of Appeals' opinion in this case. The cited portion attempts to dismiss the approach taken by the Sixth Circuit in *Horton v. Commissioner*, 33 F.3d 625 (6th Cir. 1994) (holding that punitive damages awarded in a personal injury action are excludable from gross income under 26 U.S.C. § 104(a)(2)) as having been rejected by this Court's decision in *Commissioner v. Schleier*, 115 S. Ct. 2159 (1995). The respondent's brief in opposition asserts the

1. Unless otherwise stated, all section references are to the Internal Revenue Code, Title 26, United States Code, as in effect for the taxable year at issue.

Tenth Circuit in this case observed that the decision of the Sixth Circuit in *Horton* was based upon an interpretation of this Court's decision in *United States v. Burke*, 112 S. Ct. 1867 (1992), which this Court subsequently rejected in *Schleier* (Resp. Br. 4). The clear implication from the respondent's brief is that this Court in *Schleier* overturned or changed the law as expressed by this Court in *Burke*. A reading of this Court's decision in *Schleier* demonstrates that the respondent's implication is erroneous.

The holding of *Burke* was that the underlying cause of action must be based upon "tort or tort type rights," *Burke*, 112 S. Ct. at 1870. Since the Court in *Burke* concluded that the underlying cause of action was not based on "tort or tort type rights," the Court was not compelled to inquire further. In *Schleier*, this Court went further and noted that in addition to an action based upon tort type rights the provisions of 26 U.S.C. § 104(a)(2) also require that the damages be "received on account of personal injuries or sickness." *Schleier*, 115 S. Ct. at 2167. The Court in *Schleier* thus established two independent requirements which must be met before a recovery may be excluded under 26 U.S.C. § 104(a)(2). First, is the underlying cause of action "based on tort or tort type rights"? Second, are the damages received "on account of personal injuries or sickness"? *Schleier*, 115 S. Ct. at 2167. The Court in *Schleier* does not in any way repudiate its holding in *Burke*.

The respondent's brief in opposition (Resp. Br. 6) incorporates by reference and by inclusion its brief on the merits and reply brief in *Commissioner v. Schleier*, No. 94-500 (hereinafter "Schleier Brief" and "Schleier Reply Brief," respectively). In the Schleier Brief the Commissioner makes the unsubstantiated statement that "[l]iquidated damages, like punitive damages in an ordinary tort suit, are therefore not excluded from gross income under the plain language of the

statute" (Schleier Brief at 10). This statement begs the question of the instant case. Unlike the instant case, neither *Burke* nor *Schleier* involved "an ordinary tort suit." Indeed, both were found not to involve such a suit. Respondent has never challenged the application of 26 U.S.C. § 104(a)(2) to the compensatory damage portion of the instant case; this effectively admits there is a critical distinction between both *Burke* and *Schleier* and the instant case. That distinction is the existence of an "ordinary tort suit." The question left unanswered after *Burke* and *Schleier* is whether a punitive damages award in such a lawsuit is included as a part of "any damages received . . . on account of" the personal injury and thus is excluded from gross income.

For the reasons set forth in the petition for a writ of certiorari, petitioners maintain that their situation is clearly an action based on tort rights and one in which punitive damages have been received on account of personal injuries. Thus, petitioners satisfy both of the independent requirements established by this Court in *Schleier*.

As the Schleier Reply Brief demonstrates, the so-called "plain language" of 26 U.S.C. § 104(a)(2) is capable of various interpretations. For example, the Schleier Brief at 27 notes that the Federal Circuit in *Reese v. United States*, 24 F.3d 228, 230 (Fed. Cir. 1994) concluded the "plain language" was capable of at least two conflicting interpretations — a "but for" causation approach or a "sufficient causation" approach. Furthermore, the "plain language" of the statute has been interpreted differently by the respondent over the years (Schleier Brief at 27, note 18).

What respondent has failed to do in its reading of the "plain language" of 26 U.S.C. § 104(a)(2) is to read all of the language. Section 104(a)(2) states that "any damages received . . . on account of personal injuries or sickness . . . are excludable from

income." By the use of the word "any" Congress evidenced an intent to adopt a "but for" causation approach. Congress did not provide that only compensatory damages received would be excluded, it provided that "any" damages received that were occasioned by a personal injury would be excluded. Therefore, petitioners submit the "plain language" of 26 U.S.C. § 104(a)(2) supports a conclusion exactly opposite the position taken by respondent.

Respondent further asserts that if the Sixth Circuit had an opportunity to reconsider its decision in *Horton v. Commissioner, supra*, that the court would reach a different decision (Resp. Br. 6, note 3). This is pure conjecture.

Respondent also states that this Court's denial of a petition for writ of certiorari in *Hawkins v. United States*, 30 F.3d 1077 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 2576 (1995), is reason to deny the petition for certiorari in this case (Resp. Br. 6). Respondent fails to appreciate two critical distinctions between *Hawkins* and the instant case. First, the petitioners in *Hawkins* conceded that the punitive damage award they received was "pure gain" and bore "no relationship to their injuries." *Hawkins*, 30 F.3d at 1080. Second, and more fundamentally, *Hawkins* arose as a contractual matter. The petitioners there contracted with an insurer to provide insurance coverage. The insurer breached that contract and, in addition, dealt in bad faith with the petitioners. In the instant case, the injury suffered was clearly a personal injury arising out of negligent conduct, not out of the breach of an express or implied contract. All damages received in the instant case were received "on account of" the negligent conduct of the tortfeasor.

The issue raised in this case, namely whether a punitive damages award received in a personal injury lawsuit is excludable from gross income as "any damages received . . . on

account of personal injuries. . . ." under 26 U.S.C. § 104(a)(2) has never been addressed by this Court. Unlike *Burke*, which involved an award under Title VII of the Civil Rights Act of 1964, and *Schleier*, which involved an award under Age Discrimination in Employment Act of 1967, this case presents facts in which a punitive damages award was received due to a classic "tort type" personal injury. As noted, a conflict clearly exists in the circuit courts of appeals.

II.

STATUTE OF LIMITATIONS UNDER 26 U.S.C. § 6532(b)

The issue presented is whether the statute of limitations for the recovery of an erroneous refund, 26 U.S.C. § 6532(b), begins to run on the date the refund check is placed in the mail or on the date that the check is received by the taxpayer. Section 6532(b) provides the United States may file a lawsuit to recover an erroneous refund, but "only if such suit is begun within two years after the making of such refund. . . ." Petitioners' contention is that a refund is "made" when the United States completes the last act required of it to make the refund — the placing of the check in the mail.

In its brief in opposition (Resp. Br. 7), respondent cites *Paulson v. United States*, 78 F.2d 97 (10th Cir. 1935) for the proposition that a tax refund is not "made" when it is placed in the mail. *Paulson* does not stand for that proposition. In *Paulson*, there was no indication as to whether the refund check was mailed or hand-delivered, and if mailed, when it was mailed. At most, then, *Paulson* may be construed to stand for the proposition that a tax refund is "made" no later than the date it is received by the taxpayer. *Paulson* does not explain what this Court meant when it used the terms "paid" or "delivered," and

does not exclude the possibility that a refund is "made" when the refund check is mailed.

Respondent attempts to avoid the holding of this Court in *United States v. Wurts*, 58 S. Ct. 637 (1938) by emphasizing language unnecessary to the decision in that case. Respondent asserts that the *Wurts* decision included an explanation that a refund could still be canceled "even after a check was signed and mailed" (Resp. Br. 7). Respondent thereby implies a lack of finality in a situation involving a mailed refund check. But that absence of finality has not been an obstacle to any court which has considered it. Each such court has held that the statute of limitations period commences prior to the time the taxpayer cashes or deposits the refund check. See *United States v. Woodmansee*, 388 F. Supp. 36 (N.D. Cal. 1975), *rev'd on other grounds*, 578 F.2d 1302 (9th Cir. 1978) and *United States v. Bruce*, 642 F. Supp. 120 (S.D. Tex. 1986). These courts so held even though payment of the refund check could be refused upon presentment to the Secretary of the Treasury. See 31 U.S.C. § 3328(a)(1).² Since the statute of limitations begins to run prior to the time the taxpayer cashes the refund check (when payment could still be stopped), the fact that payment could be stopped when the taxpayer receives the refund check is not justification for choosing that as the date the period of limitations begins to run.

Contrary to respondent's contention (Resp. Br. 8), *Wurts* does not say "that a refund has not yet been 'made' even when the check has been placed in the mail." *Wurts* instead holds only that the statute of limitations "begins to run from the date of

2. 31 U.S.C. § 3328(a)(1) provides "[e]xcept as provided in sections 3329 and 3330 of this title, a check drawn on the Treasury may be paid at any time. However, if the Secretary of the Treasury is on notice of a question of law or fact about the check when the check is presented, the Secretary shall defer payment until the Comptroller settles the question."

payment." *Wurts*, 58 S. Ct. at 638. The term "payment" is not defined, but the only relevant date in evidence in *Wurts* was the date the check was mailed. *Wurts*, 58 S. Ct. at 639. Therefore, the inference left by the Court in *Wurts* is that the date of mailing is the date of payment and is, therefore, the date of the "making" of the refund.

CONCLUSION

For the foregoing reasons and the reasons stated in our petition for a writ of certiorari, a petition for a writ of certiorari should be granted.

Respectfully submitted,

ROBERT M. HUGHES
Counsel of Record
JACK D. FLESHER
GREGORY L. FRANKEN
DAVID B. SUTTON
BEVER, DYE, MUSTARD
& BELIN, L.C.
Attorneys for Petitioners
106 West Douglas, Suite 700
Wichita, Kansas 67202
(316) 263-8294